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INTERNAL AUDITING AS A PANACEA TO POOR CORPORATE GOVERNANCE

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Abstract

Internal audit is the main driver of corporate governance. It is seen as an indispensible factor in ensuring sound financial reporting which increases the confidence between managers and other stakeholders . The aim of this paper is to have a critical review of related literature to unveil the impact of internal auditing on corporate governance. Another aim is to offer empirical evidence on the roles of internal auditing in enhancing the corporate governance in some companies in Nigeria. Internal auditing promotes corporate governance and its relationship to internal audit process. The paper revealed that internal auditing is an important part of the success of corporate governance, hence seen as a management tool for a successful corporate governance. It was also revealed that internal audit has a strong link that encourages value increase of an organization and its objectives. It was concluded that interactions between audit committee and internal audit help to boost corporate governance. It was recommended that internal audit increases the financial information quality and ensures the validity of financial reporting.

Keywords: Corporate governance, Internal Auditing and the role of internal auditing.

1. Introduction

It cannot be overemphasized that the increasing need for probity, separation of ownership from control, transparency in corporate operations and financial reporting had been of grave importance for any organization to succeed in this period characterized by dwindling in economies in Africa and beyond. Internal auditing and corporate governance have attracted much attention by authorities and researchers (Dewing and Russell, 2004).

The skepticism on how corporate powers are used carries with it the risk to investors that management will misuse the resources entrusted to them and act in their own self-interest even if it is detrimental to the shareholders (Jensen and Meckling in

Omolaye and Jacob, 2017). Internal audit can play a role in determining whether living with plans developed by the organization are reasonable and supported by appropriate documentation, that the right people are involved and that the risks and control are identified and addressed (KPMG, 2011). There are studies that indicate the factors which improve corporate governance. In the majority of these studies, it is stated that there is a positive relationship between the internal audit and corporate governance (Paape etal, 2003; Kanishman, 2001;Suyono and Hariyando, 2012; Sorens and Abdo lmohammadi, 2011). There are authors who raise doubt about this relationship (Regolios and d'Eri, 2012; Goodwin-Stewart and Kent, 2006).

The trend of events from the beginning of 21st century, the corporate world according to Omolaye (2017) has witnessed series of failure (Enrons, WorldCom, RBS, Northern Rock; Oceanic Bank, Intercontinental Bank) brought about a heightened public awareness to corporate governance issues. The global economic crunch in 2007 added strands to corporate governance practices and policies. Corporate governance is about the procedures and processes according to which an organization is directed and controlled (OECD 2001).Accordingly, McKinsey (2002), posited that corporate governance is a sine-qua-non for the success of any organization and by extension the heart of investment decision. According to Karagiorgos et al (2010), international guidelines suggest that effective implementation of corporate governance and internal auditing improves business performance and it is a tool for the achievement of competitive advantage. To still stress the need for a sound corporate governance, Vinteon (2002), posited that the failure of Enron corporation in the end of 2001 has as a result raised the questions about the effectiveness of contemporary accounting, auditing and corporate governance practices.

An internal auditor is expected to always tell the truth , make provision for the internal control and disclosure of wrong practice by the administration. If this truth will negatively affect the proper position and the entity of the company and also if it affects the career future of the internal auditor to a point of losing their jobs, they will be scared (Al- Hussainy, 2016).

It is noteworthy that a good internal audit standard is needed where there is a close link between the audit committee properties (independency, efficiency, professionalism and experienced members and the number of meetings) and the extent to which internal auditor apply the international standards for the professional practice of internal auditing (Alzeban, 2015). The audit committee efficiency is represented by its ability to support the internal auditor and thus applying governance principles (Sarenet al., in Sartaweand Shrawf,2017).

2. Literature Review

2.1.Conceptual framework: Corporate Governance

Corporate governance involves a set of relationships and the network between a company's management, its board of directors, shareholder and stakeholders (Omolaye, 2017). It can be defined as the system by which companies are directed and controlled (Cadbury, 1992).It also can deal with the ways in which suppliers of finance assure themselves of getting a return on their investment (Shleifer and Vishny in Omolaye and Jacob 2017).

Core et al., (1999) believe that organizations which do not invest in corporate governance, have higher agency cost as their manager's personal interests are often not in line with the organization's interest. Corporate governance is seen by Gstaunathaler, 2010 as nexus of procedures, policies, laws and regulation which plays important role in the way an organization is governed and controlled. Brom and Velentza (2012) believe or determines the relationship between management, ownership and other interested parties of the organization and also sets goal. Corporate governance also includes social responsibility, ethical business practices, issues correspondence in internal and external audit and full transparency on financial results (Bunget et al in

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Ionesca 2009). Corporate governance has a main driver based on the Agency concept, corporate bodies are overseen by those who are appointed by the owners (Rickett in kontogeorgis 2018).

It is essential to state that the main aim of corporate governance is to ensure that the organization will be directed under specific guidelines which will serve the interest of every party in the organization including the board of directors, managers and other stakeholders no wonder Duhnfort et al (2008), advised that corporate structure should comply with each country's formal laws and regulations, the generally accepted accounting principles, the ethical standard and the cultural differences.

Corporate governance according to Broni and Velentzas (2012) captured two different concepts namely long-term concept and financial concept, the long term strategic concept involves the relationship and communication between managers and shareholders in order to achieve a productive cooperation, While the financial concept describes the relationship between the two parties based on structure, rules and regulation, in order to achieve a high level of information, disclosure and transparency in financial statements and therefore mutual confidence in their transactions.

Corporate governance is structured into five elements in the organizations internal environment such as long term strategic goals and human resources, the external environment such as corporate social responsibility, relationship with suppliers, customer, and compliance to rules and regulations (Hart in Droglas, Arampatzis and Anagnostopoulou 2016).

Corporate governance can be evaluated using qualitative and quantitative tools. If the governance mechanisms are not disclosed the firms stakeholder may not be able to have access to calculate a quality corporate governance (Darmadi 2013). According to Omoleye and Jacob 2017, the report of Security Exchange Commission (SEC) in April 2003 showed that the corporate governance is at its rudimentary stage because only about 40% of quoted companies, banks inclusive had recognized codes of corporate governance in place. In specifics, for the finance sector, poor corporate governance was identified as one of the major factors in virtually all known instances of a financial institution's distress in the country. According to central Bank of Nigeria report in 2006, it is identified that poor corporate governance was caused by weak internal control which is the primary area of internal audit function: as a panacea to poor corporate governance.

Corporate governance has two forms of models, namely the Anglo-America model and the European model, in Anglo-America model, there is a board of directors that constituted of both executive and non executive members who are chosen by the shareholders. The non executive members are usually more than the executive members and form the audit committee which is a board responsible for corporate governance matters. In the other model, there are two different boards, the executive board composed by executive of the company and the supervisory board which is comprised by non executive members who represent the shareholders and have similar rights and responsibilities to the audit committee (Broni and Valentzas, 2012).

In a good corporate governance, a well timed and legitimate disclosure of financial information and transparency in financial reporting are matters of concern with regards to corporate governance structure. The role and the responsibilities of the board of directors and the control mechanism by management and shareholders are considered of outmost importance (Robertson et al in Drogalas, Arampatzis and Anegnostopoulon, 2016). Corporate governance is also strongly seen as a move to carryout a business in accordance with owners and shareholders ambition (Milton Friedman in Kontogeorgis, 2018).The importance of corporate governance is seen by Cattery(2005) to have qualitative impact on the following;

- Efficient use of corporate asset attracts investor's confidence.

- Ability to meet social expectation, progress and national prosperity.
- It improves the performance of business and growth prospects.
- The ability to attract low-cost capital (Hirschman,1970,Spanos, 2005).

Corporate governance though with significant implication for growth prospect of an economy reduces risk for investor, attracts investment capital and improves corporate results (Spanos, 2005).

The corporate governance statement is not only a useful statement but provides information about the quality of corporate governance of the organization concerned. The following according to Kontogeorgis(2018) are some information content of a corporate governance statement.

- It mentions which corporate governance code is implemented by a company.
- It gives details about the operation of the general assembly and describes the obligations and the rights of shareholders.
- It states what best practices implemented by a company without being obligated by the law.
- It describes the process of internal control and risk management which a company implements for the purpose of protection of investors.
- It describes relationship with shareholders
- It gives information about the composition of the board and the other committee of the company. It discloses the number of the executive and the non executive members of the board.
- It gives information about the remuneration of the members of the board.
- It gives explanation about the deviation of the corporate governance code.
- It gives information about the rules on the appointment of the members of the board and the procedure for their replacement.
- It reveals information about the rights which have the ministry shareholder and how they are protected.

- It gives information about the shares which a company may have in the other business.

2.2.Internal Auditing

It is vital to elaborate more on internal auditing as a panacea to poor corporate governance in any organization. Internal auditing is seen as a monitoring function, organizational policeman and watch dog tolerated as a necessary component of organizations control but deemed dutiful to the achievement of major corporate objective (Morgan in Omolaye and Jacob, 2017).

The series of structure changes in recent years and the implementation of new rules and regulation concerning internal audit, the evolution of new technologies, the economic crisis and the need for more intensive and continuous auditing by companies resulted in many changes, not only in the process of internal audit but also in the role of internal auditors and the general scope of internal audit (Beklans, et al., in Drogolas, Arampatzis and Anagnostopoulou, 2016). According to Arampatzic et al (2016), the new approach of internal auditing approach, the consulting role of internal audit, in line with strategic management is emphasized. It also stated that internal audit must add value to an organization and contribute to the achievement of corporate goals (Arampatzic et al., 2016).

The view of Hass, AbdolMohammadi and Burnaby (2006) on the new expanded scope of internal audit focused on the contribution of internal audit of risk management and corporate governance issues. According to Godwin-Stewart and Kent (2006), up to 2006, authors had reported a weak support for collaboration between corporate governance and internal audit. There is also an observed and increasing responsibility of internal auditor in providing over sight function on financial reporting process which includes the internal control system, no wonder Bishop, HeamansonLopides and

Rittenbough (2000) posit that internal auditing becomes a key factor of monitoring, auditors are required to ensure more effective processes control, internal auditing is therefore a valuable resources for audit committee to meet their mandate related to financial reporting. Internal audit is considered a control mechanism used by private and public organization, this control mechanism is seen as those processes put in place to monitor, direct, promote or restrain the various activities of an organization to ensure that the objectives are met (Coram, Ferguson and Moroney in Omolaye and Jacob 2017). Accordingly, the internal auditors play significant role in monitoring an organization's risk profile and identifying areas of improvement in risk management (Reynolds 2000).

It is important to note that all weaknesses internal auditors are signaling as well as their recommendations aiming at improving processes and strengthening controls will ensure the objectives achievement, cost reductions, use of opportunities and in this respect will deliver value for the organization (Stanceis 2012). An optimum model of corporate governance has the key characteristic of internal audit as auditor's independence and objectivity with an important impact on internal control effectiveness (Lepadatu, 2011). The effective internal audit function is supposed to assist management to fulfill its governance responsibilities (Radu 2012). This the internal audit in its new perspective should provide objective, relevant and reliable opinions on management's assessment despite the fact that most of internal control weakness are related to financial statements and procedures (Caratas and Spatariu 2014).

The concept of audit quality means the effectiveness of internal audit, but Ragoliosi and Eric (2012) posited that due to the intangible nature of internal audit function, it is difficult for an organization to evaluate the quality of internal audit and to measure the contribution of audit service to a company. The position of internal audit as a penance to poor corporate governance is supported by Cohen et al (2002) who posited that

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auditors as part of the internal control system of a company hence considered as important actors in the corporate governance field, they also revealed that the association between the audit process and the corporate governance is enhanced by the fact that weak corporate governance structures seem to cause a decrease in the quality of financial information reported and even results in financial fraud.

The above position is consistent with the findings of Krishman's 2001 who found out that problems of internal audit procedures are related to weak governance structures. Recently a study on the association of corporate governance with internal control, internal audit and organizational commitment shows that internal control and internal audit have a positive significant relationship with good corporate governance (Suyono and Hariyano, 2012). Still on the relevance of using internal auditing as a panacea to poor corporate governance, Adolmohammadi (2011) believes strongly that the size of companies internal audit department and its plans depend on the various elements of corporate governance like having an internal audit department as a percentage of the external members in the board of directors or control environment.

With due consideration in the consulting role of internal audit and its contribution to corporate governance, DeAngelo in Drogolas Arampatzis and Anagnostopoulon (2016) saw audit quality as separating the internal audit activity into two stages, firstly detecting irregularities on the financial statement of the organization and secondly reporting on it.

2.3.Other Roles of Internal Auditing to enhancing Corporate Governance

According to Omolaye and Jacob(2017) who saw corporate governance as an attempt to implement some risk analysis, verification and control system with the objective of developing an effective and efficient management and governance. Internal auditing supports it with a vital role in assisting in the maintenance, reorganization of the internal control system and management in general. Evidently, there are various aspects of corporate governance, paucity of research investigation on the nature and extent of internal auditing on governance issues in Nigeria business environment.

Internal auditing clearly includes in its roles the recommendation for risk management through internal control and audit, this relationship can be seen as intricate part of the stewardship model of corporate governance (Holm and Laursen in Omolaye and Jacob 2017). Moreso, internal control and audit has been a central concept in the debate on regulating corporate governance and financial reporting (Omolaye and Jacob 2017). They are also of the view that the relationship between internal auditing and corporate governance has increased significantly in recent years, auditing regulations from society and the auditors' rules and regulations have forced a closer view on internal control and audit, hence believe that internal auditing function as a risk management tool is a key ingredient in corporate governance regulations.

The performance of an organization in corporate governance has got much to do with the impact and roles played by internal auditing in that organization. The influence of well organized internal audit department translates to a good and sustainable level of good performance no wonder Jeusen and Meekling in Omolaye and Jacob (2017) suggested that a positive correlation exist between performance and good governance. They also believed that internal audit function is a panacea for positive organizational performance. Authors whose views are consistent to the view above include Eden and Mariah (1996) who posited that internal audit makes a valuable contribution to organizational effectiveness in terms of objective measures.

The roles of internal auditor in ensuring a good corporate governance, according to Chamber and Odar (2015),include the following considered as the responsibilities of an internal audit.

- Internal governance mechanism

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- Information presented to the board and management so as to take the right decision
- Risks of poor customer service
- Risks such as capital and liquidity
- Results of processes.

Ordinarily, the following internal audit function play extra roles for a company, the roles according to Pinto et al (2014) are;

- It helps management to identify threats and opportunities so as to improve its results. It helps in the decision making process of companies.
- It maximizes the potential risk which may face a company.
- It increases the social responsibility of a company and as a result the image of the company to be improved.
- It improves the effectiveness and efficiency of the company performance.
- The above roles clearly show that internal auditing is an important part of corporate governance and also a vital tool for effective management of a company.

3.0.Conclusion.

There is a significant positive relationship between internal audit function and the performance of corporate organization through operational efficiency, growth and higher profitability.

Recent development in regulation increased the awareness and changes in organizational culture based on corporate governance, the internal audit functions and its roles. Internal audit functions have an impact on defining corporate structures. The results on the consulting role of internal audit are in consonance with the regulations of Sarbones-Oxley and other existing literatures. The presence of an effective internal audit functions within an organization could prevent misstatements in financial reporting.

Internal audit could be regarded as a standard for measuring management and board's effectiveness in corporate governance circumstances. It is also concluded that the interaction between audit committee and internal auditors does not only enhance corporate governance but seen as important booster for it, hence internal auditing is a panacea to poor corporate governance.

4.0.Recommendations.

1. Auditors should establish an internal auditing council to enable them keep up to international standards of internal auditing.
2. Laws of most African countries to follow international internal audit standards because it is important in enhancing corporate governance and by extension economic development.
3. Internal auditors should at all times exercise their duties with professionalism, objectivity and fair play.
4. Internal auditing function should be continually supported by management and the audit committee in terms of adequate staffing, training and compensation for effectiveness.
5. It is recommended that compliance tests should be carried out normally to ensure corporate governance principles are not circumvented.

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